ICRA

Dodla Dairy Limited

Instruments	Amount In Rs. Crore	Rating Action
Term loans	77.94	[ICRA]A+; upgraded, outlook revised to Stable from Positive
Cash credit*	72.50	[ICRA]A+/[ICRA]A1; upgraded, outlook revised to Stable from Positive
Short-term fund-based facilities	30.00	[ICRA]A1; upgraded
Unallocated limits	7.06	[ICRA]A+; upgraded, outlook revised to Stable from Positive

**Cash credit interchangeable with short term loans*

ICRA has upgraded the long-term rating assigned to the Rs. 77.94 crore[1] term loans and Rs. 7.06 crore unallocated limits of Dodla Dairy Limited (DDL/Dodla)[2] to [ICRA]A+ (pronounced ICRA A plus) from [ICRA]A- (pronounced ICRA A minus). ICRA has also upgraded the ratings assigned to the Rs.72.50 crore cash credit facilities of DDL to [ICRA]A+/[ICRA]A1 (pronounced ICRA A one) from [ICRA]A-/[ICRA]A2+ (pronounced ICRA A two plus). Furthermore, ICRA has upgraded the short-term rating assigned to the Rs. 30.00 crore short term loans of DDL to [ICRA]A1 from [ICRA]A2+. The outlook on the long-term rating has been revised to Stable from Positive.

The ratings upgrade reflects DDL's ability to sustain its growth momentum supported by increase in milk procurement from new geographies and improvement in its product mix towards higher proportion of value-added product sales, which contributed to 35% of its sales in H1FY2017 as compared to 20% in FY2015. Liquid milk sales, which remained sluggish in FY2016, improved in H1FY2017 with DDL witnessing around 10% growth in liquid milk sales volume. This coupled with significant growth in value-added products enabled DDL to report an OI of Rs.711.91 crore in H1FY2017—19% growth year-on-year. In FY2016, the raw milk procurement cost per litre reduced by 5% year-on-year whereas the average realisation increased marginally by 1%, improving the operating margin (OPM) to 8.2% in FY2016. The raw milk procurement cost increased by 6% in H1FY2017 with no commensurate increase in realisations resulting in a moderation in the operating profitability to 6.0%. However, the OPM reported in H1FY2017 is in line with the ICRA expectations and cash accruals continue to remain robust. Moreover, DDL's coverage and leverage indicators have improved considerably in the last one year and its liquidity position remained comfortable supported by unencumbered liquid surplus of Rs.63.62 crore as on September 30, 2016.

The ratings continue to factor in the well established position of ***Dodla*** brand and its diversified presence in the districts of Andhra Pradesh, Karnataka and parts of Tamil Nadu and Telangana. DDL's established procurement base among dairy farmers supplemented by a wide network of bulk coolers and chilling centres provides the company a steady source of liquid milk. The ratings also draw comfort from the favourable growth prospects given the low penetration of organised sector in the dairy industry and the net worth augmentation as a result of private equity infusion of around Rs.110 crore in FY2013 by Black River Asset Management (BRAM)[3], thereby resulting in comfortable capital structure. BRAM is planning to exit DDL during CY2017; however, there is no buyback obligation on DDL. DDL also benefits from the investor's experience in the dairy sector and the added focus on corporate governance. DDL's entry into newer geographies and its ability to develop value-added products are crucial for sustaining the current growth momentum.

The ratings are, however, constrained by the commoditised nature of operations; high competition from organised co-operatives, private sector and unorganised players; and its vulnerability to external factors such as weather and disease outbreaks. Given the high competition from milk cooperatives especially in Karnataka and Tamil Nadu, which account for around half of DDL's turnover, DDL's pricing flexibility in these markets are constrained given the existing high price differential between the milk co-operatives and DDL in these states—

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[1] 100 lakh = 1 crore = 10 million

[2] For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications.

[3] Black River Asset Management founded in 2003 is a wholly-owned subsidiary of Cargill, Incorporated. The size of the current fund is approximately $300 to $400 million and is focused on agribusiness – buying into dairy farms and breeding fish in Asia and Latin America.

although the company has been able to pass on the hike in input costs in the past. The company plans to add one lakh litre per day of processing capacity every year and set up the requisite procurement network to support the raw milk requirement at the new plants. ICRA expects the capital structure to remain at the existing level, given that the proposed capex is planned to be largely funded through internal accruals.

Going forward, the ability of the company to maintain its profitability through sustained improvement in procurement base of milk, thereby limiting its dependence on SMP; successfully enter newer geographies; and control the overall indebtedness would be the key rating sensitive factor. Dodla would remain exposed to event risks such as climatic vagaries and epidemics.

Company Profile

Incorporated in 1995, DDL is a public limited company promoted by Mr. D. Sesha Reddy and Mr. D. Sunil Reddy. After the private equity fund infusion in FY2013, the promoters hold 76.34% and the remaining 23.66% is held by Black River CPF Holdings (Mauritius) Limited. The company processes and sells milk and milk products under the ***Dodla*** brand, with a market presence predominantly in three southern states viz. Andhra Pradesh, Karnataka, Tamil Nadu and Telangana. DDL has ten processing and packaging units, with a capacity of processing 11.10 lakh litres per day.

Recent results

As per the unaudited results, the company reported a turnover of Rs. 711.91 crore with an operating profit of Rs. 42.50 crore in H1FY2017. Dodla reported a turnover of Rs. 1182.37 crore and an operating profit of Rs. 96.50 crore in FY2016.

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